

2001 INVESTMENT CLIMATE STATEMENT

Introduction: With the right policy framework and a strong commitment to reform, Indonesia would be able to capitalize on its fundamental economic strengths to restore investor confidence. The nation offers a large domestic market and a correspondingly large workforce, abundant natural resources, reasonably modern telecommunications and other infrastructure, a strategic location along some of the world's major trade routes, and substantial experience with market-based economics and the international trade and payments system. Nevertheless, the Indonesian investment climate has suffered from the combination of a worldwide economic slowdown and increasing domestic political instability. Investor confidence remains depressed, with existing and potential investors citing a number of concerns: political uncertainty, the unknown impact of political and fiscal decentralization, uneven implementation of economic reform commitments, the unreliable judicial system, security issues, and treatment of existing investors.

Political uncertainty: Indonesia's first democratically elected President Abdurrahman Wahid has battled growing political instability throughout his administration. The President has changed his economic advisors frequently. Most recently, a month before a special session of the People's Consultative Council (MPR) to debate his impeachment scheduled for August 1, the President has reshuffled several key economic positions. Continued power jockeying among the parties, ministries, legislature, central bank, and other institutions has further complicated investors' assessments of Indonesia's political outlook.

Decentralization: On January 1, 2001, two laws devolving authority and funding to district governments entered into effect. The process is disorganized and there is confusion as to the limits and scope of the new authorities. Inter-ministerial turf battles have also complicated the process. The newly amended law on local taxation gives local governments the freedom to impose new taxes and levies within certain limits. Many of the new taxes target foreign investors or trade with other regions. It is not clear whether the central government will act to rein in those taxes that are unnecessarily burdensome. Local governments now have the authority to approve investments in all areas except oil and gas, which remains a central government preserve. Investment rules and procedures -- approval criteria for new investments, licensing arrangements, etc -- remain unclear. Many local governments have criticized Jakarta's slow pace and lack of consultation in formulating implementing regulations for the decentralization laws.

Economic reform: The GOI's progress on structural reform issues slowed in the second half of 2000 and throughout 2001 causing Indonesia to fall seriously behind on its three-year, IMF-supported economic reform program. As of June 2001, Indonesia faced the following key economic and structural reform challenges:

- Restoring balance to Indonesia's economy by reducing inflation, controlling the GOI's budget deficit, and spurring economic growth.
- Enhancing the environment for foreign investment by improving security,

reducing political conflict, and improving the functioning of Indonesia's commercial courts.

- Increasing state budget revenues by expanding Indonesia's income tax base and privatizing state-owned enterprises (SOEs).
- Recovering some of the costs of Indonesia's Rp 430 trillion bank recapitalization program by selling assets held by the Indonesian Bank Restructuring Agency (IBRA).
- Finalizing debt-restructuring Memorandum of Understandings (MOU) between Indonesia's corporate debtors and their foreign and domestic creditors.
- Refining budget mechanisms under fiscal decentralization in order to improve administrative capacity at the district level, improve the equity of resource transfers among the regions, and reduce the overall fiscal burden of the program on the central government budget.
- Increasing transparency and accountability of government operations.

An additional challenge for both the GOI and foreign investors is coping with exchange rate volatility. The rupiah has been on a downward path since mid-2000, and has depreciated by over 18 percent in 2001.

The GOI has articulated a strategy for rebuilding the banking sector, restructuring corporate debt, and undertaking other structural reforms, particularly in the justice sector, but implementation has been uneven. Moreover, disposal of IBRA-held assets has been very slow, few debtors and former bank owners have been taken to court, and privatization of SOEs has not gotten off the ground.

Judicial system: The GOI has taken some steps to foster judicial independence by the promulgation of the Law on the Judiciary (No. 35/1999) which transfers most of the administrative and regulatory functions related to the court system from the former Ministry of Justice (now styled the Ministry of Law and Legislation) to the Supreme Court, and by forming an independent National Law Commission in December 1999. Nevertheless, the government still has not announced a thoroughgoing plan for justice sector reform, and the judicial system still does not offer fair and impartial protection for investors.

Indonesia still ranks among the lowest in transparency and corporate governance assessments of Asian countries. Perpetrators of Soeharto-era corruption and the Habibie-era Bank Bali campaign finance scandal have not yet made accountable, although a multitude of investigations into these and other (human rights, for example) cases have been launched. Indonesia's Bankruptcy Law, which was amended in 1998 to establish a separate Commercial Court, has been a disappointment to creditors. The lack of legal certainty surrounding contract enforcement and differential treatment of

domestic versus foreign companies are major concerns to foreign investors. The courts have issued rulings that ignore binding arbitration clauses in contracts, for example, in cases involving independent power producers and a Swiss pharmaceutical firm.

Existing investors: In addition to enduring the more general problems affecting the investment climate, existing investors -- particularly in extractive industries -- have suffered considerable specific problems at the hands of central and regional government officials. Some have been criticized by cabinet officers and other members of the government, who have alleged that contracts concluded under the Soeharto government were impaired or who have accused companies of environmental, labor, human rights, and other abuses. These allegations have not been accompanied by evidence or followed up with legal action. Local communities, impatient for the benefits of decentralization, have sought to obtain extra-contractual concessions from companies operating in their areas. Some non-governmental groups, which have enjoyed unprecedented freedom since former President Soeharto's fall, have also criticized foreign investors. Various foreign investors have also experienced labor unrest. Some mining and oil and gas ventures have been forced to suspend operations as a result of these and related problems.

Security: Plantations and mining operations in particular have been affected by security issues. Looting, occupation of land by squatters, and illegal mining are among the problems investors face. Outbreaks of sectarian violence in Maluku, Lombok, Central Sulawesi and other parts of the archipelago, as well as separatist movements in Aceh and Papua, continue to challenge national unity. A perceived breakdown in law and order hinders the government's ability to guarantee the security of foreign and domestic investments. Filling the security void are a growing number of vigilante groups, who have made security concerns more acute.

Despite its economic and political difficulties, Indonesia has maintained a relatively open foreign investment regime and has even taken some concrete steps to streamline its investment application and permit processes and to facilitate foreign investment. Investment approval values recovered in 2000 and have continued to do so in 2001. According to the most recent statistics covering January 1, 2001 through March 31, 2001, foreign investment approvals were up about 375 percent, rising from USD 810.4 billion for the same period in 2000 to 3045.1 billion in 2001. (Investment approvals often do not result in actual investments, but merely indicate investor interest.)

Note: The following discussion summarizes the legal, regulatory, and de facto investment framework as of mid-2001. Further changes in the executive branch of government may occur following the August MPR session. The FY 2001 April–December 2001 budget assumes an average exchange rate of Rp 9600/USD. The exchange rate used throughout this report is Rp 11,300/USD 1, the rate prevailing at the time of publication. In addition, investment approval rates are calculated by the Government of Indonesia based on a separate formula.

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A. Openness to Foreign Investment

Indonesian government policy is to encourage private sector-led growth and foreign investment. President Wahid has adopted increasing foreign investment as a personal cause, and since taking office has carried a message of welcome in his foreign travels. In 1998 and 1999, the GOI issued several new regulations to ease the entry of foreign firms and capital into Indonesia. However, the Foreign Capital Investment Law of 1967, which provides the basic framework for foreign investment, is still in effect. Representatives of several ministries are working together to draft a revised Foreign Capital Investment Law that may go into effect as early as 2002. The law has been under revision for almost three years and its reform comprises one of the objectives of the GOI's IMF-supported economic reform program.

Investment in Indonesia is categorized as either domestic (PMDN) or foreign (PMA). An investment with any degree of direct foreign ownership is defined as PMA. The Capital Investment Coordinating Board (BKPM) -- now subsumed under the Board of Investment and State-Owned Enterprises (BPM-PBUMN) -- plays a key role in promoting foreign investment and approving project proposals. The relevant technical government departments handle investments in the oil and gas, banking, and insurance industries. BKPM, or the corresponding provincial board (BKPMMD), approves foreign and domestic investment in all other sectors.

While BKPM/BKPMMD aims to function as a one-stop investor service, investors are routinely required to work closely with relevant technical government departments, such as Finance, Manpower, and Justice, as well as regional and local authorities, unless they investing in Bonded Zones (Kawasan Berikat) or in Integrated Economic Zones (KAPET). Recent reforms have freed investors from some

cumbersome documentary requirements resulting from the need to work with other departments and local governments. One significant change is that master lists of capital goods and basic material imports for both foreign and domestic investments are approved by BKPM/BKPMD and no longer need clearance from the Directorate General of Customs and Excise.

The GOI has also made efforts to streamline and simplify foreign investment application processes. For example, approvals for foreign investment over USD 100 million no longer must be approved by the President of Indonesia, but can now be approved by the Chairman of BKPM. Currently there are no restrictions on the investment level (below USD 100 million) that can be approved by a BPKMD. Starting in January 2000, some provinces, among them the Jakarta District, West Java, West Kalimantan, and East Kalimantan, started accepting foreign investment applications. With the implementation of decentralization, each province will eventually be able to accept applications. A limited number of Indonesian embassies and consulates abroad can also accept and process foreign investment applications.

Obtaining initial investment approval (IIA) now takes on average less than 10 working days, a marked improvement from the past when application processing could take months. The IIA serves as a temporary operating license for a period up to three years (the license can be extended), and it enables the PMA company to start its commercial activities. The IIA allows the parties to form a limited liability company (Perseroan Terbatas, or P.T.) by executing through an Indonesian notary a Deed of Establishment. The Articles of Association of the PMA company are included in the Deed of Establishment and must comply with Law No. 1/1995 on Limited Liability Companies. Once executed, the Deed of Establishment is submitted to the Ministry of Law and Legislation (MOLL). Approval usually takes more than the 60-day statutory maximum, and until companies receive formal approval, the founding shareholders are personally liable for all obligations undertaken in the name of the company. Once the permission has been received, the PMA company must be registered in the Company Registry under the Department of Industry and Trade and the Deed of Establishment published in the Supplement to the State Gazette (Tambahan Berita Negara). The time between formal MOLL approval and publication in the Supplement can take more than a year, during which the directors of the company are jointly and severally liable for actions taken in the name of the company.

The IIA can be used until the PMA company reaches the state of commercial operation or commercial production. At that point, the PMA company must apply through BKPM or the appropriate BKPMD for a Permanent Business License (Ijin Usaha Tetap, or IUT). This licensing process can take months.

A foreign investor may be an individual or a corporate entity. Private entities may establish, acquire, and dispose of interests in business enterprises. Current regulations permit foreign firms to acquire domestic firms in sectors open for foreign investment after receiving approval from BKPM. When reviewing applications from foreign firms seeking to acquire locally established firms, BKPM frequently requires the buyer to reserve a small stake for a local buyer or the original owner or to inject

capital, in addition to management expertise, technology, or assuming outstanding loans. The approval process to take over a "sick" firm may take as long as two months. In 1998, the GOI established the Jakarta Initiative, with a mandate to eliminate obstacles to corporate debt restructurings. In May 1999, the government issued regulations providing incentives for corporate debt restructurings that could address some of the obstacles to foreign investment in existing, but distressed, firms.

Some sectors are closed to all private or foreign investment. According to the latest "Negative Investment List", published by the Ministry of Investment and State-Owned Enterprises in August 2000, 11 business sectors are closed to both foreign and domestic investment, while eight are closed only to foreign investment. Sectors closed to foreign investment are:

- germ plasm cultivation,
- forest concessions,
- timber extraction and processing,
- taxi/bus transport,
- small-scale marine shipping,
- trade and support services (except for large scale retailing, distribution and wholesaling services, exporters and importers, exhibition/convention service providers, quality certification service providers, market research service providers, warehousing service providers other than Level I and seaports, and after-sale service providers),
- radio and television broadcasting,
- print media, and
- film production, distribution and exhibition.

Copies of the negative list are available from U.S. Commercial Center in Jakarta and, on the Internet, at WWW.USEMBASSYJAKARTA.ORG - see Commercial Center.

Since the early 1990's, the government gradually opened previously restricted sectors to foreign investment, some conditionally. Ports, electricity generation, telecommunications, shipping, airlines, railways, and water supply have all been opened in part or in full. Foreign investment opportunities in many services sectors remain restricted. The government is continuing to develop policies on the private provision of infrastructure through build-own-operate and build-operate-transfer schemes, particularly for electric power, telecommunications, and roads. Full foreign ownership is not permitted in these sectors. Local partners are required to own anywhere from five to 51 percent of these investments. Electric generating plants that were developed as independent power projects under Power Purchase Agreements ran into difficulties with the sharp depreciation of the rupiah starting in mid-1997 and led the Indonesian Government to postpone or seek re-negotiation of the financial terms of these projects.

Separate from the negative investment list, the government has reserved several sectors for small-scale enterprises. Investment in these sectors for large or medium-scale foreign or domestic companies may be possible but the large-scale enterprise must partner with a small business or cooperative before an investment application would be approved. Presidential Decree No. 99/1998 on Small-scale

Enterprises details sectors open only to small businesses and those open to medium and large-scale companies in partnership with smaller firms.

The GOI has eliminated many restrictions on foreign investment in retail and wholesale operations. Foreign firms are now allowed to invest directly in both wholesale and large-scale retail trade sectors (generally interpreted as shopping centers, malls, supermarkets, and department stores), with the condition that they enter into a cooperative agreement with a small-scale enterprise. Such an agreement, in practice, has not required equity participation by the small-scale enterprise. In addition, many foreign firms use franchising, licensing, and technical service agreements to distribute their goods. Indonesia has also lifted many restrictions on foreign participation in domestic distribution services.

Under current regulations, foreign companies manufacturing in Indonesia may distribute their locally produced goods at the wholesale level and may apply for permits to import and distribute other products as well. These licensing procedures may be substantially affected by decentralization. However, companies engaging in wholesale distribution may not conduct retail operations directly, but must form a separate retail company. Further, the number of expatriate employees granted visas to work in any single wholesale and retail business is limited.

Current rules (Government Regulation No. 20/1994 and Ministry of Investment Decree No. 15/1994) mandate a fifteen-year time limit after which foreign companies must divest a percentage (usually one to five percent) of their shares to an Indonesian citizen to take up minority holding in the company. U.S. firms are urging the GOI to eliminate the condition as a means to further improve Indonesia's investment climate.

Oil and gas: The Indonesian government, through state oil and gas company Pertamina, owns all oil and hydrocarbons in the ground. Oil contractors (mainly foreign) operate under production sharing contracts (PSC) and variations of PSCs to explore and produce hydrocarbons from a licensed area. The contractor is reimbursed for allowable expenditures. In return, the contractors have certain rights to split oil and gas production with Pertamina.

The Indonesian government has submitted an oil and gas bill to Parliament, but its passage has been slowed by the ongoing political crisis. The bill contemplates a gradual phase-out of Pertamina's responsibility for Production Sharing Contracts (PSC) and a shift in management of PSC contractors from Pertamina to the central government. The draft law also calls for an end to Pertamina's monopoly over downstream oil distribution and marketing of fuel products.

Mining: Foreign investors operate under coal contracts of work (CCOW) and contracts of work (COW) for general mining. The contractor conducts all stages of the operation and assumes all financial and operational risks. The government submitted a mining bill to Parliament in June, however, that will abolish the CCOW and COW and eliminate other distinctions between foreign and domestic investors in

the mining sector. If the bill is passed, investors will conduct exploration activity and operate mines under the authority of a “mining operation permit” or “mining operation agreement.” The draft law also recognizes changes created by the implementation of Law 22/1999 on Fiscal Decentralization and Law 25/1999 on Regional Autonomy which delegated responsibility for mineral resources to regency-level government.

Banking, Securities and Insurance: A 1988 deregulation package partially opened the banking, securities and insurance industries to foreign investment. In 1998, in keeping with its commitments under the World Trade Organization's (WTO) Financial Services Agreement, the government equalized the capital requirements for domestic and foreign insurance firms. In a move that exceeded its WTO commitments, the GOI later amended the 1992 Banking Law to allow full foreign ownership of banks and removed restrictions on foreign bank branches outside of Jakarta. The Ministry of Finance licenses new securities and insurance ventures; Bank Indonesia, the central bank, licenses banks and regulates banking activity.

Privatization: To enhance the efficiency of state-owned enterprises (SOE) and as part of Indonesia's ongoing IMF-supported economic reform program, the GOI established an ambitious timetable to divest majority ownership in SOEs. Difficulties establishing the valuation of the state-owned firms, resistance from senior managers and political leaders to selling key national assets, and the challenge of attracting buyers in an uncertain political and economic environment has resulted in the program never getting off the ground.

On June 29, 2000, the GOI launched a revised State-Owned Enterprise Masterplan in response to concerns about lagging privatization and continuing “high-cost” practices in the 164 enterprises. The revised plan aimed to accelerate SOE restructuring and privatization and to establish good governance practices (transparency, independence, and accountability) within the parastatals. The government slated 10 companies from a variety of sectors, including mining, plantations, airport operations and fertilizer, to be fully or partially privatized before the end of 2000, with proceeds expected to total Rp 6.5 trillion (USD 604 million). The obstacles facing the privatization process have persisted, however, and the government failed to meet its FY 2000 target. It has set the same target for FY 2001, but has conducted only two small initial public offerings of state pharmaceutical companies netting USD 23 million.

Conversion and Transfer Policies

The value of Indonesia's currency, the rupiah, has fluctuated significantly since Indonesia floated it in August 1997. Following a sharp depreciation sharply from 2,500/USD in July 1997 to a low of 17,000/USD in June 1998, the rupiah had strengthened to Rp 6,700/USD at the time of President Wahid's selection on October 20, 1999. Since March 2000, however, the rupiah has depreciated steadily from Rp7,590/USD to Rp 11,200/USD in late-June 2001, a decline of almost 49 percent.

Bank Indonesia introduced new foreign exchange regulations in January 2001

that have significantly cut back the flow of rupiah to offshore markets. The regulations place limits on the quantity of rupiah that onshore banks may transfer to offshore parties without underlying trade or investment transactions. These limits, currently set at USD 3 million, apply to both each transaction and to a bank's cumulative derivative transaction position, including forward sales, swaps, and option contracts. Despite the new restrictions on offshore transfers of rupiah, Indonesia has no system of capital controls and foreign exchange flows freely in and out of the country. No prior permits are necessary to transfer foreign exchange. Foreign investors have the right to repatriate capital and profits at the prevailing rate of exchange. The government does not place restrictions on outward direct investment. Foreign Exchange Law No. 24/1999, which entered into force in April 2000, requires the reporting of all foreign exchange transactions above USD 10,000.

Expropriation and Compensation

Article 21 of the 1967 Foreign Capital Investment Law stipulates that the government shall not initiate nationalization of foreign investments except by law and when such action is necessary in the interest of the state. According to BKPM, no foreign investment has been expropriated since the passage of the 1967 law. In 1999, however, OPIC paid a claim by an U.S. investor after the Indonesian Government failed to honor an arbitration award. Although there has been concern that a post-Soeharto government might nationalize projects or abrogate contracts awarded to firms connected to the family of former President Soeharto, Indonesian government officials have stated that foreign firms will not be expropriated in the process of dismantling the business empires of former first family members. However, several foreign companies who signed contracts during the Soeharto era have had their contracts challenged by provincial and local governments and NGOs. The GOI has threatened to assume control of day-to-day operations of a partially foreign-owned joint operations partner (KSO) if the company and state-owned telecommunications provider Telkom fail to reach an agreement in an ongoing contractual dispute.

Dispute Settlement

The Indonesian government has agreed to submit any investment disputes to the International Center for the Settlement of Investment Disputes (ICSID) in Washington, D.C. A long-pending investment dispute involving an U.S. investor was resolved through the ICSID in 1993. Indonesia has signed on to UNCITRAL (United Nations Commission on International Trade Laws) arbitration rules. Foreign firms have entered arbitration hearings in Indonesia under UNCITRAL administration. An Indonesian investment arbitration board, BANI, is available when both parties to a dispute agree to submit to its arbitration.

Indonesia is also a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards. The record of enforcement of foreign arbitral awards is, however, weak. In practice, foreign companies have had great difficulty enforcing foreign arbitration awards or getting the judicial system to honor arbitration clauses in contracts involving foreign investors. In 1999, Indonesia enacted

a Law on Arbitration that addresses many concerns, but the new law's impact has been limited.

Disputes between Independent Power Producers (IPP) and the state electric company PLN and lack of respect for arbitration rights clauses in contracts, as in the Swiss pharmaceutical company's case, have been cited by many foreign chambers of commerce operating in Indonesia as major causes for alarm and strong deterrents to further investment in Indonesia. Electric generating plants that were developed as independent power projects ran into difficulties when the sharp depreciation of the rupiah led the Indonesian Government to postpone projects or seek renegotiation of the terms of Power Purchase Agreements.

The court system does not provide effective recourse for solving commercial disputes. The judiciary is nominally independent, but irregular payments and other collusive practices often influence judicial outcomes. The GOI has recognized that the legal system must be modernized. Legal and judicial reform is an important part of Indonesia's economic reform program. Amendments to the Bankruptcy Law entered into effect in August 1998, but the court's performance has been extremely weak.

Indonesia enacted laws on consumer protection, anti-corruption, and anti-monopoly/competition in 1999. However, the regulatory frameworks to enforce these new laws remain incomplete.

Performance Requirements and Incentives

The GOI has notified the WTO of its compliance with the WTO Agreement on Trade-related Investment Measures (TRIMS).

Various fiscal incentives are available to both foreign and domestic investors. A company producing for the domestic market may apply for import duty exemptions on all required machinery and equipment as well as on raw and supporting materials needed during the first two years of commercial production. A company producing 65 percent for export has additional incentives. It may apply for restitution of import duties paid on inputs that are subsequently re-exported in finished form. Special investment incentives in the form of income tax, value-added tax, and luxury tax exemptions are made available on a case-by-case basis by BKPM.

The GOI re-introduced basic tax holidays with Government Regulation No. 45 of 1996. Under this regulation, specific sectors, including capital goods manufacturing, agribusiness, infrastructure, sea and air transport, engineering, and professional personnel training may be eligible for tax holidays. Presidential Decree No. 7/1999 laid out the evaluation criteria for tax facilities for new investors entering designated "pioneer" industries. According to the decree, the basic incentive period is three years, with an additional two years for investments outside of Java and Bali. The incentive period can be extended for investments that employ more than 2,000 Indonesian workers, are at least 20 percent held by an Indonesian cooperative, and/or whose total investment is USD 200 million or more excluding land and buildings.

Tax exemption for qualifying investments begins at the start of commercial operations or after the project is licensed, whichever comes first. Time beyond five years to achieve startup will be deducted from the period of the tax incentives. In January 2000, following the signing of a new Letter of Intent with the International Monetary Fund, the GOI announced it would withdraw all or at least some of its tax facilities for new investors as listed in Decree No. 7.

Indonesia expects foreign investors to contribute to the training and development of Indonesian nationals, allowing the transfer of skills and technology required for their effective participation in the management of foreign companies. As a general rule, a company can hire foreigners only for positions that the government has deemed open to non-Indonesians. Employers must have manpower-training programs aimed at replacing foreign workers with Indonesians.

At present, Indonesia does not have formal regulations concerning U.S. and other foreign firms' participation in GOI-financed and/or subsidized research and development programs on a national treatment basis. The State Ministry for Research and Technology handles applications on a case-by-case basis. However, the Ministry is currently drafting regulations to enable interested parties to pursue their interest in a clear and systematic manner.

Indonesia does not have rules requiring that investors purchase from local sources or export a certain percentage of output. Rules that encouraged investors to locate in industrial estates were diluted in June 1998. Foreign firms are not required to disclose proprietary information to the government before investing.

Right to Private Ownership and Establishment

Indonesia recognizes the right to private ownership and establishment and has relied heavily on the private sector -- albeit at times heavily protected -- as the principal engine of its economic growth. Parastatals have traditionally played an important role as well. Their role declined as private sector activity grew and privileges awarded to state-owned enterprises decreased. A State Ministry for State-Owned Enterprises was formed in 1998; privatization was an important part of its mandate.

The Indonesian Bank Restructuring Agency is the GOI's lead agency for dealing with the after effects of Indonesia's 1997-98 financial crisis. It has three main tasks:

-- Restoring to health, restructuring, and ultimately disposing the 11 banks the GOI recapitalized or took over during the crisis. Although IBRA announce it would sell a 30 percent stake in the largest of these banks, Bank Central Asia, by the end of June 2001, it postponed the sale. It is also scheduled to sell a smaller recapitalized bank, Bank Niaga, in 2001.

-- Restructuring and disposing the approximately Rp 310 trillion in non-performing

corporate, commercial, and consumer loans it received from recapitalized banks or banks it took over during the crisis. These loans are estimated to have a market value now of 20-25 percent of their book value.

-- Disposing the approximately Rp 112 trillion in corporate, property, and industrial assets pledged by five former bank owners to settle liquidity credits they received in 1998-99.

IBRA's mandate is time-bound and its stewardship of formerly private assets is to be temporary. However, IBRA has suffered numerous delays in meeting its mandate, and has only disposed of 5-10 percent of its assets to date. In the 2001 budget, the GOI assigned IBRA a Rp 27 trillion (USD 2.45 billion) cash collection target as well as a Rp 10 trillion (USD 910 million) target for swapping restructured loans for recapitalization bonds. However, despite calls by some senior political figures for IBRA to speed up its asset sales, the GOI has not assigned the agency specific asset sales targets.

Protection of Property Rights

Indonesia has suspended many private infrastructure projects, especially in the field of private power generation, for economic and political reasons. The U.S. Embassy and other U.S. government entities have vigorously emphasized to the Indonesian government the importance of honoring internationally binding contracts and urged that all project reviews and contract negotiations be conducted in a rule-based, consistent, objective, and transparent manner.

Mortgages and secured interests in chattel and real property are recognized, but a comprehensive and efficient recording system is not in place. Foreign entities have no freehold rights to land ownership in Indonesia. Foreign investors' land holdings are often obtained through long-term lease agreements with the government. Leases are generally for 20 or 25 years and are renewable up to 100 years. These lease holdings can be used as collateral. Enforcement of secured interests is problematic. The financial crisis of 1997-1999 revealed that many large-scale debtors had pledged the same assets to multiple creditors. Foreign companies may also establish a Limited Liability (in Indonesian *Perusahaan Terbatas* or PT) company under Indonesian law that can legally own property.

The court system does not provide effective recourse for settling property disputes. Indonesia's decentralization process has unleashed a flurry of new land claims by local residents against companies, often operating on government-granted concessions located in their communities.

In April 2001, the USG placed Indonesia on the Special 301 priority watch list in response to continued problems in the enforcement of intellectual property rights. Indonesia has made progress in improving the regulatory and legal framework for protection of intellectual property rights. Effective enforcement of IP rights is still extremely difficult and this is unlikely to change without a dramatic improvement in

the effectiveness of Indonesia's justice sector. In December 2000, Indonesia enacted new laws governing the protection of industrial designs, integrated circuits and trade secrets. Effective enforcement of IP rights through Indonesia's justice system is still very difficult. Indonesia is a member of the World Intellectual Property Organization and a party to the Paris Convention for the Protection of Intellectual Property. Indonesia has acceded to the Berne Convention and signed the Trademark Law Treaty. Other international agreements to which Indonesia is party include the Nice Agreement for the International Classification of Unclassified Goods and Services, the Strasbourg Agreement Concerning International Patent Classification, and the Budapest Treaty on the International Recognition of the Deposit of Microorganisms.

Patents: Indonesia's parliament passed a new, revised patent law on July 2, 2001. The legislation increases fines for patent infringement and establishes an independent patent commission to rule on disputes and appeals. Products and production processes are patentable for a period of 20 years commencing from the filing of the patent application, subject to certain requirements. Drawbacks in the law include compulsory licensing provisions, and a provision that limits patent protection to patents that are "implemented" in Indonesia. In practice, this means that pharmaceutical products must be manufactured in Indonesia to receive patent protection. The law also transferred jurisdiction of the patent cases from the district court to the Commercial court. The impact of this move is a major unknown. None of the handful of Indonesian judges with IPR expertise currently sits on the Commercial court.

Trademarks: Indonesia passed a new, slightly amended trademark law on July 2, 2001. This law states that trademark rights are determined on a first-to-file basis rather than on a first-use basis. After registration, the mark must actually be used in commerce. The law offers protection for service marks and collective marks and sets forth a procedure for opposition prior to examination by the trademark office. It also provides well-known trademark protection, although, to the detriment of several foreign marks, procedures for registering trademarks as well known have not been fully developed. The new law was intended to make cancellation actions easier. Previously they had been difficult to implement and had to be lodged within five years of the trademark registration date.

Copyright: Parliament passed amendments to the 1982 copyright law in 1987 and March 1997. The amended law affords protection to foreign works, expands the scope of coverage and raises the terms of protection to international standards. The United States and Indonesia concluded a bilateral copyright agreement extending reciprocal protection in 1989. In May 1997, Indonesia reacted to the Berne Convention on copyright protection. The government has proposed new legislation that will increase penalties for copyright infringement.

New technologies: Indonesia passed a new law for the protection of plant varieties in December 2000. The U.S.-Indonesia Science and Technology Agreement ensures protection for intellectual property derived from cooperative activities under the agreement's umbrella.

Transparency of the Regulatory System

Indonesia has a tangled regulatory and legal environment where most firms, both foreign and domestic, attempt to avoid the justice system. Laws and regulations are often vague and require substantial interpretation by implementing offices, leading to business uncertainty. Deregulation has been somewhat successful in removing barriers, creating more transparent trade and investment regimes, and has alleviated, but not eliminated, red tape. Transparency problems and red tape are routinely cited by U.S. businesses as factors hindering their operations in Indonesia. Please refer to Overview and Corruption sections for information on GOI reform efforts.

Efficient Capital Markets and Portfolio Investment

Individual banks determine deposit and lending rates, although the blanket government guarantee on banks' payment obligations covers interest on deposits up to a stipulated percentage only. As of mid-2001, most Indonesian and foreign banks reported very little loan growth. While accounting and bank disclosure standards have improved, they are still not considered consistent with international norms.

Indonesia's capital market expanded rapidly during the 1990s, led by growth of the equity market. The Jakarta Stock Exchange is the dominant securities market in the country, but transaction volumes in 2001 remain well below their pre-crisis levels. The lack of a well-developed bond market remains a limiting factor for Indonesia's financial sector.

Foreign firms generally enjoy good access to the Indonesian securities market. Financial reforms introduced in 1987 allowed foreign firms to form joint ventures with Indonesian partners in the securities market as underwriters, broker-dealers, and investment managers. The 49-percent restriction on foreign purchases of shares in non-bank listed firms was lifted in 1997, and for banks in 1999. Discriminatory capital requirements on foreign securities were removed in 1998. Portfolio investment is regulated by BAPEPAM, the Indonesian equivalent of the Securities and Exchange Commission.

One factor limiting the growth of Indonesia's capital markets has been the large amount of non-performing corporate debt, estimated at USD 65 billion in late 2000. Although debtors and creditors have reached agreement on a substantial number of restructuring terms sheets through IBRA and the Jakarta Initiative Task Force, few of these agreements have reached legal closing. As a result, few of Indonesia's corporations are creditworthy.

Political Violence

American citizens are urged to defer nonessential travel to Indonesia, and all travel to Aceh, Maluku, West Timor, Central Sulawesi, Papua (Irian Jaya) and Central and West Kalimantan. Those who reside in Indonesia or must visit should exercise

extreme caution, be aware of their surroundings and use common sense to avoid situations and locations that could be inherently dangerous.

The cities of Jakarta and Medan, in addition to other locations, have been struck by a number of bombings in recent months. The Jakarta Stock Exchange, diplomatic facilities and Indonesian government buildings have been targeted. A massive bombing campaign struck churches throughout Indonesia on Christmas Eve, leaving 16 dead and over one hundred injured. The U.S. Embassy has had indications that this wave of bombings may continue.

East Timor voted for independence from Indonesia in an August 30, 1999 referendum and is currently under the authority of the United Nations' Transitional Administration in East Timor (UNTAET). UNTAET was established by a unanimous vote of the UN Security Council on October 25, 1999 for the purpose of rebuilding East Timor and helping to establish a new government. Violence erupted throughout East Timor after the August 30, 1999, United Nations-sponsored ballot in that province. Although stability has largely returned to the territory following the arrival of international forces, crime and lawlessness remain a major problem. American citizens are strongly encouraged to exercise caution in East Timor and to avoid areas along the border between East and West Timor.

The western half of the island has been the scene of several physical assaults on foreigners by disgruntled pro-integration Timorese militia forces. American citizens are encouraged to defer non-emergency travel to West Timor, especially in areas where East Timorese refugees are concentrated.

Political changes have given new impetus to aspirations for independence in Aceh and Papua. Violent incidents continue to occur in Aceh and American citizens are strongly urged to defer all travel to that province. Violence has targeted American companies with growing frequency. American citizens resident in Aceh should consider departing. In Papua, violence has been less frequent. The government of Indonesia has restricted the travel of U.S. and other foreign government officials to the provinces of Aceh, Papua, and Maluku. Security concerns are cited as the reason for this prohibition. American citizens should take this into account when planning travel to these regions. As of mid-2001, this restriction remained in effect.

Americans should remember that many parts of Indonesia, including many tourist destinations, are isolated and difficult to reach by available transportation or communication links. In cases of unrest, medical emergency or logistical problems, travelers may find it difficult to depart quickly. Americans also should be watchful while in urban areas, where demonstrations and other violence can occur without warning. Americans should avoid large crowds and potential demonstration sites.

The Department of State encourages American citizens considering travel to Indonesia to review carefully the information available in the State Department's Consular information sheet, available on the internet at

<http://www.usembassyjakarta.org> or on the Bureau of Consular Affairs' home page at <http://travel.state.gov>.

Corruption

In recent years, considerable attention has focused on the costs of corruption and influence peddling to local and foreign businesses, and the economy as a whole. Since the fall of Soeharto, the identification and elimination of corruption in government and widespread collusive business practices have become national issues. A newly freed press provides extensive coverage of past and current corruption investigations but successful prosecutions have been rare. In 1999, the Parliament passed two landmark laws designed to fight corruption, particularly in government activities. The first, Law No. 28, requires senior government officials to disclose their wealth and subjects them to audits. A commission has been established, with enforcement powers, to review those audits. In April 2001, the commission for the first time released the reported wealth of top government officials and this received widespread press coverage. The Commission did not audit the reports. The second, Law No. 31, widens the definition of corruption, increases penalties and establishes an anti-corruption commission. The commission is not yet operational as of mid-2001.

Surveys of business executives working in Asia have ranked Indonesia among countries where corrupt practices are most pervasive and act as a disincentive to direct foreign investment. Demands for "facilitation fees" to obtain required permits or licenses, government award of contracts and concessions based on personal relations, and a legal system that is often perceived as arbitrary are frequently cited problems. A number of high-profile corruption cases have been widely reported in the press although none of the accused has been brought to trial. Meanwhile, petty corruption appears to be flourishing. Foreign companies have little success in filing formal complaints through either legal or administrative channels. Foreign companies continue to report difficulties in obtaining and renewing necessary immigration permits for expatriate staff based in Indonesia. In some cases, unsubstantiated corruption allegations have been made by government officials against foreign companies, particularly those operating in the resources sectors, but there has been no evidence presented or prosecution of corruption cases against foreign investors.

Bilateral Investment Agreements

Indonesia has signed investment protection agreements with 52 countries, including the United States (Agreement on Investment Guarantees), Argentina, Australia, Bangladesh, The Netherlands, Belgium, Chile, People's Republic of China, Czech Republic, Denmark, Finland, Hungary, United Kingdom, Italy, India, Jamaica, Germany, Jordan, Cambodia, South Korea, Cuba, Kyrgyzstan, Laos, Malaysia, Morocco, Mauritius, Mozambique, Egypt, Mongolia, Norway, Pakistan, France, Poland, Romania, Singapore, Slovak Republic, Spain, Sri Lanka, Sudan, Suriname, Syria, Sweden, Switzerland, Thailand, Tunisia, Turkey, Turkmenistan, Ukraine, Uzbekistan, Vietnam, Yemen, and Zimbabwe. Indonesia has also signed treaties for the avoidance of double taxation with 50 countries, including the United States. On

February 1, 1997, an amendment to the U.S.-Indonesia tax treaty went into effect that reduced withholding rates to 10 percent, on par with rates accorded by Indonesia to Japan and major European countries.

OPIC and Other Investment Insurance Programs

Since 1967, all three types of Overseas Private Investment Corporation (OPIC) insurance - inconvertibility, expropriation, and war, revolution and insurrection - have been provided to U.S. investors in Indonesia. OPIC coverage was extended to bid bonds on service contracts in 1987. OPIC has also provided project financing to companies with at least 25 percent U.S. ownership.

Labor

The labor force, according to the most recent annual Labor Force Survey from 1999, is estimated at about 140 million, of which about 75 percent are between the ages of 15 and 34. The labor force has grown by an average of 2.5 percent over the past 30 years, although this rate is decreasing with the drop in fertility rates, increasing urbanization and lengthening school attendance. Women make up approximately 51 percent of the work force. Before the economic crisis began in 1997, the Indonesian government estimated "open" unemployment (defined as a person who is working less than one hour a week) to be roughly 4 percent. The Ministry of Manpower estimates that 37.4 million persons (27 percent of the labor force) were unemployed or underemployed. The Labor Force Survey includes workers employed in the informal sector, while government estimates focus on job losses from formal sector employment. Some economists, unions, and other non-governmental observers have criticized the Labor Force Survey as understating real unemployment; these other sources estimate that more than half of the population is under-employed.

Before the economic crisis, the educational level of Indonesia's labor force had risen to the point that some 26 percent of non-agricultural workers had graduated from high school, and about five percent had educational achievement at a university level. Only 25 percent of the non-agricultural workers had not completed primary school, although this figure reached almost 50 percent within the agricultural work force. However, high inflation and large-scale layoffs have squeezed family incomes and caused about 6 to 8 million students to drop out of school since the onset of the economic crisis, according to GOI and NGO estimates.

The United States has traditionally been a top choice for Indonesians wishing to study abroad. In the 1999-2000 academic year, there were an estimated 11,300 Indonesians studying in the United States, marking a 6.9-percent decline from the 1998-1999 academic year (Institute for International Education (IIE) statistics). Approximately 70 percent were in undergraduate programs, 24 percent in graduate programs, and the remaining 6 percent in non-degree programs, including English language studies. The decline in enrollment of Indonesian students in U.S. colleges, universities, and other institutes of higher education is largely attributed to the drop in

the rupiah's value in relation to the dollar. While Indonesian students are the eighth largest foreign national group studying at the higher education level in the United States, they are the fourth largest group studying at community colleges. Community colleges offer more affordable academic programs, an attractive advantage to students whose financial resources may have declined with the depreciation of the rupiah.

Job creation and the alleviation of underemployment are targets of economic policymaking, especially in light of the massive layoffs caused by the economic crisis. The unemployment rate for higher education graduates was much higher than the overall unemployment rate even before the crisis. Nonetheless, Indonesia is experiencing shortages of qualified managerial and professional personnel.

The government sets minimum wages by region. The minimum wage in Jakarta was set at Rp. 426,250 per month as of January 25, 2001. Labor strikes have become increasingly common in recent years, due to poor economic conditions and growth of the trade union movement. There are currently 39 registered labor unions. In 2001, there were a number of strikes related to severance pay and fuel price hikes that forced the Government to postpone implementation of related legislation and/or increase consumer prices, thereby increasing the cost of living.

Indonesia's industrial relations system is in flux. Indonesia's Parliament has not yet acted on two draft laws related to trade union rights and industrial dispute resolution. The current uncertainties about changes in labor law, exacerbated by the inadequate dissemination of existing labor laws, cause considerable confusion for both labor and management. In addition to uncertainties about changes in labor law, there is considerable confusion about enforcement and interpretation of existing law and regulations.

Foreign Trade Zones/Free Ports

Foreign and domestic industrial companies located in any of Indonesia's seven designated bonded zones are provided with several incentives. The largest bonded zone is Batam, located just south of Singapore. Investors in bonded zones are not required to apply for additional implementation licenses (location, construction, and nuisance act permits and land titles), and foreign companies are allowed 100 percent ownership. These companies do not pay import duty, income tax (Article 22), value added tax (VAT), and sales tax on imported capital goods, equipment, and raw materials until the portion of production destined for the domestic market is "exported" to Indonesia, in which case fees are owed only on that portion. Companies operating in bonded zones may also lend machinery and equipment to subcontractors located outside of the bonded zone for a maximum two-year period. The companies have also enjoyed exemption from VAT and sales tax on luxury goods on the delivery of products to subcontractors for further processing outside of bonded zones.

In April 2000, the GOI issued revised regulations intended to eliminate VAT and luxury tax exemptions on sales of goods for internal consumption in Batam. Goods for export would have remained exempt from these taxes. However, Batam

authorities and foreign investors there protested the proposed changes and President Wahid agreed to postpone its implementation. As of July 2001, it has still not been implemented.

Foreign Direct Investment Statistics

Domestic and foreign investment approvals rose in 2000 for the first time since the onset of the economic crisis in 1997. Foreign investment approvals reached almost USD 15.5 billion, 41 percent higher than 1999. First quarter investment approval values continue to show strong growth. According to most recent BKPM statistics covering January 1, 2001 through March 31, 2001, foreign investment approvals rose by almost 276 percent, rising from USD 810 million in the same period in 2000 to USD 3 billion in 2001. The value per project rose from USD 2.5 million to USD 10.7 million during the same period of time.

CAUTION: BKPM approval reports should be treated cautiously and used as no more than an indicator of possible trends because they represent applications to invest and not actual projects or money. Moreover, the value of the investment in an application is the investor's estimate and may not accurately reflect actual investments made. Indonesia does not report on actual investments. However, Indonesia's balance of payments statistics indicate that Indonesia is still experiencing a net outflow of investment due to the repayment of debts associated with earlier investments. The net investment statistics reported by Bank Indonesia (in USD billions): -0.4 in 1998, -2.7 in 1999, and -4.1 in 2000.

For the first quarter of 2001, the chemical and pharmaceutical sectors (approvals valued at about USD 1.5 billion) was the most attractive sector for foreign investment applications, followed by the basic metal, engineering, and electronics sector (USD 304 million), textile sector (USD 204 million), hotel and restaurant (USD 171 million), and rubber and plastics (USD 128 million). Through the same period, Japan led in approved foreign investment applications (2 projects worth about USD 1.5 billion), followed by Malaysia (19 projects worth USD 449 million), Japan (22 projects worth USD 278 million), Singapore (61 projects worth USD 200 million), the United Kingdom (35 projects worth USD 184 million), and the United States (7 projects worth 27 million).

Except as noted, the data used here come from the Capital Investment Coordinating Board (BKPM), the central processing point for investment applications. BKPM handles all sectors except oil and gas, finance, banking, non-bank finance, insurance, and leasing. BKPM approval reports should be treated cautiously, and used as no more than an indicator of possible trends because they represent applications to invest and not actual projects or money. For example, the mid-1990's approvals were inflated for several years by a surge of interest in oil product refineries, most of which were never constructed. Moreover, the value of the investment given in an application is the investor's estimate and may not accurately reflect the value of any actual investment. Year-on-year comparisons of domestic approvals after the rupiah began to decline in mid-1997 are difficult because of the currency's fluctuating value.

Table 1. Foreign Investment Approvals, 1996-2000

Year	No. of Projects	Total Value (USD Million)	Average Value/Project (USD Million)
2000	1,508	15,413	10
1999	1,164	10,891	9
1998	1,035	13,563	13
1997	790	33,833	43
1996	959	29,929	31

Table 2. Top Ten Sectors By Value Per Year, 1996-2000

Sector	Project	Total Value (USD Million)
2000		
Chemicals	89	7,448
Trade	499	1,441
Transportation/Telecom	61	1,218
Metal Goods	132	1,005
Basic Metal	8	824
Food Industry	39	701
Textiles	107	401
Food Crops	17	311
Real Estate	21	302
10. Hotel/Restaurant	48	260
1999		
Chemicals	75	3,266
Electricity/Gas/Water	2	2,310
Paper	15	1,412
Food Industry	48	681
Metal Goods	85	593
Basic Metals	9	501
Plantations	17	284
Trade	348	279
Textiles	121	240
Food Crops	10	224
1998		
Chemicals	73	6,173
Electricity	6	1,795
Real Estate	19	1,271
Metal Goods	119	891

Plantations	22	725
Hotel/Restaurants	56	451
Basic Metals	13	394
Food Industry	32	342
Non-Metal Minerals	15	237
Food Crops	10	224
1997		
Chemicals	93	12,563
Transportation/Telecom	36	5,900
Paper	14	5,353
Metal Goods	190	2,332
Electricity/Gas/Water	8	1,840
Non-Metallic Minerals	17	1,457
Real Estate	20	1,394
Food Industry	26	573
Textiles	5	373
Food Crops	3	234
1996		
Chemicals	91	7,361
Electricity/Gas/Water	8	3,809
Metal Goods	186	2,939
Paper	16	2,907
Real Estate	35	9,628
Hotels/Restaurants	34	1,717
Mining	4	1,697
Plantations	18	1,168
Non-Metallic Minerals	28	790
Food Industry	37	691

**Table 3. Foreign Investment Approvals by Region
1996-2000**

Year	Region	Total Investment (USD Million)	% Year- on-Year Change
2000	Java	10,613	303
	Sumatra	2,999	(61)
	Kalimantan	137	40
	Sulawesi	70	(50)
	Maluku/Irian	52	108
	Bali	130	(33)
	Nusa Tenggara	1,413	9320
	Total	15,431	42

1999	Java	2,636	(76)
	Sumatra	7,653	440
	Kalimantan	227	(69)
	Sulawesi	141	26
	Maluku/Irian	25	78
	Bali	193	(38)
	Nusa Tenggara	15	(79)
	Total	10,891	(20)
1998	Java	10,840	(47)
	Sumatra	1,416	(87)
	Kalimantan	723	(32)
	Sulawesi	193	(55)
	Maluku/Irian	14	(97)
	Bali	309	167
	Nusa Tenggara	70	367
	Total	13,565	(60)
1997	Java	20,535	15
	Sumatra	11,164	160
	Kalimantan	1,056	(63)
	Sulawesi	426	(83)
	Maluku/Irian	522	(1)
	Bali	155	(70)
	Nusa Tenggara	15	(99)
	Total	33,833	13
1996	Java	17,908	(35)
	Sumatra	4,298	(22)
	Kalimantan	2,874	74
	Sulawesi	2,553	7
	Maluku/Irian	528	(79)
	Bali	380	66
	Nusa Tenggara	1,388	967
	Total	29,929	(25)

Table 4. Foreign Investment Approvals by Top Ten Counties of Origin, 1996-2000

Country	No. of Project	Total Value (USD Million)
2000		
UK	79	3,645
Japan	93	1,954
Netherland	43	1,159
Germany	28	960

South Korea	284	688
Singapore	218	536
Somalia	1	260
U.S.	51	241
Malaysia	74	168
China	43	160

Country	No. of Project	Total Value (USD Million)
1999		
Saudi Arabia	5	3,007
Australia	61	2,458
Taiwan	91	1,489
Singapore	147	731
Japan	70	644
UK	72	507
South Korea	201	263
Malaysia	50	186
U.S.	46	136
Germany	38	87

Country	No. of Project	Total Value (USD Million)
1998		
UK	49	4,745
Japan	78	1,331
Singapore	126	1,268
Malaysia	63	1,060
U.S.	46	568
Hong Kong	18	549
Netherlands	33	412
South Korea	112	202
Taiwan	91	165
Australia	69	85

Country	No. of Project	Total Value (USD Million)
1997		
UK	31	5,477
Japan	94	5,421
Germany	15	4,468
Taiwan	101	3,419
Singapore	118	2,299
Malaysia	59	2,289
South Korea	67	1,410
U.S.	32	1,018

Netherlands	22	320
Hong Kong	17	251

Country	No. of Project	Total Value (USD Million)
1996		
Japan	145	7,655
UK	38	3,391
Singapore	134	3,131
Malaysia	43	1,393
Netherlands	27	1,330
South Korea	55	1,231
Hong Kong	34	1,106
U.S.	51	642
Taiwan	111	536
Australia	58	446